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TAGS: [ECON](#) [EAID](#) [ETRD](#) [AM](#)

SUBJECT: U.S. INVESTORS WIN IMPORTANT VICTORY AGAINST GOAM
TAX SERVICE

REF: Yerevan 52

1. (U) Sensitive but unclassified. Please protect accordingly.

SUMMARY

2. (SBU) On June 16, Armenia's court of appeals ruled in favor of a group of American investors who have been trying, for over two years, to collect USD 2 million in taxes that they had overpaid to the GOAM during the privatization and renovation of the Marriott Hotel Armenia. As the largest U.S. investment in Armenia backed by the Overseas Private Investment corporation (OPIC) and the International Finance Corporation (IFC), the case was the best known example of a problem common to nearly all foreign investors in Armenia: the GOAM's failure to repay overpaid Value-Added Tax (VAT). In this case, as in the many other claims against the Tax Service, no one seriously disputed that the tax was overpaid. The Tax Service has been notoriously loath to part with cash, even ignoring previous court judgments. For the first time, it appears that the tax service is prepared to honor the court's verdict in this case, a move that could lend confidence to other businesses with large outstanding VAT refund claims. End Summary.

RELUCTANT JUSTICE

3. (SBU) The Hotel Armenia's dispute with the GOAM is a familiar one for foreign investors in Armenia. As part of their privatization and investment agreement, they were entitled to VAT refunds on all capital investments as part the 2001-2003 renovation of the Hotel Armenia. (Note: By law, foreign capital investment and exporting industries are entitled to VAT exemptions. End Note.) Nevertheless, the GOAM never returned USD 2 million in overpaid VAT claiming that tax laws and other bureaucratic barriers denied the Tax Service "a mechanism" to return the money that they acknowledged they owed. In 2003, the investors sued the tax authorities, winning both in lower court and on appeal. The Tax Service never honored the judgment. The parties then reached a settlement in 2004 whereby the hotel could offset other tax obligations against the VAT overpayment. The government backed out of that agreement, leading to the present proceedings. After postponing the court hearings twice, the court has ruled against the Tax Service a second time. Following the ruling, the Tax Service still will not refund the tax in cash, but has agreed to honor the earlier settlement to offset the amount, an acceptable outcome for the investors.

A STEP FORWARD FOR ARMENIA'S VAT ARREARS PROBLEM

4. (SBU) Shortcomings in Armenia's revenue services (in particular their failure to return overpaid VAT) are among the greatest scourges to Armenia's business climate. By the end of 2003, outstanding VAT refund claims amounted to 1.3 percent of GDP and 10 percent of annual tax revenue. Recognizing this problem, the GOAM in 2004 promised as an IMF conditionality not to accrue new VAT arrears to businesses and to pay back the old arrears. The GOAM also made similar pledges to us during the Fall 2004 and Spring 2005 meetings of the U.S.-Armenia Task Force (USATF). According to U.S. businesses, the tax service has since done a good job not accruing new arrears: one company had more VAT returned to it during 2004 than in six years of prior business. The GOAM had not yet started to pay back the stock of larger arrears like those owed to the Hotel Armenia. Deals like this, allowing companies to offset these arrears against current tax liabilities could be a hopeful sign that the GOAM is ready to confront this problem.

U.S. ENGAGEMENT KEY TO POSITIVE OUTCOME

15. (SBU) The Hotel Armenia case was the focal point for Armenia's problem in VAT administration. We raised this case and the general VAT refund problem repeatedly at the ministerial level and with the head of the State Tax Service. The Ambassador raised this specific case at two meetings of the U.S. - Armenia Task Force (USATF), and Embassy EconOff along with representatives from the IFC and Marriott Corporation conspicuously attended all court hearings.

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COMMENT: TAX ENVIRONMENT IMPROVING--TOO SLOWLY

16. (SBU) While the experience of the Hotel Armenia may sound discouraging to future investors, the fact that the Tax Service seemingly intends to honor a judgment of the court against them (and the fact that the investors were able to get the court to rule against the powerful tax service) is a hopeful sign. Two years ago the VAT regime was so bleak that many foreign businesses had stopped claiming VAT refunds and simply wrote them off as expenses. In line with President Kocharian's January 2005 call for reform of the Tax Service (reftel), foreign companies are now reporting in many cases that they are getting their current VAT refunds on schedule. While we acknowledge the fact that this outcome might not have been reached without our engagement, it is another sign that Armenia's tax environment may be becoming more friendly, and that the impunity of Armenia's Tax Service is waning, albeit reluctantly and too slowly.
EVANS